WILLCUTS, COLLECTOR OF INTERNAL REVENUE, *v.* BUNN.

CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

No. 22. Argued December 2, 1930.—Decided January 5, 1931.

1. The profits derived by an investor in municipal bonds from their sale by him at a higher price are taxable as income under the Revenue Act of 1924. P. 223.
2. Federal taxation of such profits is not unconstitutional as a tax on state instrumentalities. So *held* where it did not appear that the bonds had been issued at a discount so that the gain derived from their resale could be considered to be in lieu of interest. P. 224.
3. The power to tax is no less essential to our governmental system than the power to borrow money. To preserve the latter, it is not necessary to cripple the former by exempting subjects which fall within the general application of non-discriminatory tax laws, where their taxation lays no direct burden upon a governmental instrumentality, and exerts only a remote, if any, influence upon the exercise of the functions of government. P. 225.
4. In the case of the bonds of a State or its political subdivisions, the subject held to be exempt from federal taxation is the principal and interest of the bonds. Such obligations being contracts of the State or subdivision, a tax upon the amounts payable by their terms has been regarded as bearing directly upon the exercise of the governmental borrowing power. P. 226.
5. But sales of such bonds by their owners, after they have been issued, are transactions distinct from the governmental contracts in the bonds; and the profits on such sales are in a different category of income from the interest payable on the bonds. P. 227.
6. Sales of such bonds by those who have invested in them cannot be deemed inseparably connected with the exercise of the borrowing power of the State, so as to make immune from federal taxation the profits of the sales. P. 228.
7. Before the power of Congress to lay the excise in question can be denied as imposing a burden upon the State's borrowing power, it must be made to appear that the burden is real, not imaginary; substantial, not negligible. Pp. 230, 234.

8. The assertion that such taxes operate to burden governmental power to borrow, is at variance with uniform and long established practice. The history of income tax legislation is persuasive, if not controlling, upon this question of practical effect. Pp. 232, 234.

35 F. (2d) 29, reversed.

CERTIORARI, 280 U. S. 551, to review a judgment affirming a recovery by the present respondent in his suit against the Collector for money paid the latter, under protest, as an additional income tax.

Assistant Attorney General Youngquist, with whom *Attorney General Mitchell,* and *Messrs. J. Louis Monarch* and *Morton Poe Fisher,* Special Assistants to the Attorney General, *Clarence M. Charest,* General Counsel, and *T. H. Lewis, Jr.,* Special Attorney, Bureau of Internal Revenue, were on the brief, for petitioner.

When bonds are sold by a municipality, the price is the then market price. The prospect of profit in excess of the interest or discount is not held out as an inducement. Possible profit from resale, as well as possible loss, depends upon eventualities. It is one of the risks accepted by the owner. The interest on the bond comes to the owner without further effort on his part. It is an exact obligation of the municipality, met with regularity. But gains or losses from sale by the owner result from a combination of factors, including business judgment and sagacity in purchases and sales. The gain, briefly, is derived from a combination of capital, industry, and skill. *Tax Commissioner* v. *Putnam,* 227 Mass. 522, 531. And the tax upon income, including such gain, is not a tax upon any sum received pursuant to the contract provisions of the bond. It is submitted that the use of the general term "income" in certain of the opinions of this Court dealing with the immunity of obligations of the States from taxation by the United States, or *vice versa,*

is not controlling on the question of the immunity of the particular sort of "income" represented by such a gain.

The rulings of the Treasury Department (O. D. 647, 3 C. B. 123; O. D. 737, 3 C. B. 49; O. D. 762, 4 C. B. 31) have consistently held that where a municipality originally issues a bond at a discount and redeems it at par, the return represented by the discount is interest in another form and not taxable; but the exemption has been limited to the amount of the discount, and profit resulting to the holder from the sale has been held taxable.

The court below held that a tax upon income, to the extent that it includes gain from the sale of exempt securities, is an unwarranted interference with and burden upon the exercise by the municipality of the vital function of borrowing money. This conclusion was based upon the premise that the tax would have an economic effect upon the price of such securities. The theory is applicable to the present case only if the United States is restrained by a rule, without exception, to the effect that it can not levy any tax which may, to the slightest perceptible degree, place a burden upon the marketing of municipal securities, or to such degree render them less saleable. *Plummer* v. *Coler,* 178 U. S. 115, 136, 137, demonstrates that the rule is by no means so stringent. See also *Orr* v. *Gilman,* 183 U. S. 278; *Greiner* v. *Lewellyn,* 258 U. S. 384.

The relation of the tax to the security in this case is more remote than a tax on transfers of decedents' estates measured by a value which includes exempt securities. The injury here is neither obvious nor appreciable. The borrowing capacity of States and municipalities has not been curtailed. See *National Life Ins. Co.* v. *United States,* 277 U. S. 508, 532.

The cost to States, counties, and cities of borrowed money has remained practically constant in a rising money

market. Grimes & Craigue, Principles of Valuation, 1928, p. 204.

See *Nauts* v. *Slayton,* 36 F. (2d) 145, 147; *Flint* v. *Stone Tracy Co.,* 220 U. S. 107; *Macallen Co.* v. *Massachusetts,* 279 U. S. 620; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 523; *Heiner* v. *Colonial Trust Co.,* 275 U. S. 232; *Gillespie* v. *Oklahoma,* 257 U. S. 501.

The broad provisions of the income tax laws were intended to include income generally. *Irwin* v. *Gavit,* 268 U. S. 161, 166. It is clear that § 213 (a) of the Revenue Act of 1924, is broad enough to require gains from the sale of municipal securities to be included in gross income. The provisions of the Constitution will not preclude such tax unless the burden is obvious and appreciable. Every presumption is in favor of the constitutionality of an Act of Congress. *Nicol* v. *Ames,* 173 U. S. 509; *Stratton's Independence* v. *Howbert,* 231 U. S. 399; *St. Louis S. W. Ry.* v. *Arkansas,* 235 U. S. 350, 369.

Mr. Charles Bunn for respondent.

The fundamental basis of the exemption of instrumentalities of States from federal taxation (and *vice versa*) is no doubt still the necessity of self-preservation announced in *Collector* v. *Day,* 11 Wall. 113. But this Court has made it clear that there are certain instrumentalities of States so closely connected with their existence as independent Governments that any tax upon them by the United States is void. *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 524.

Where the instrumentality is of this class, exemption does not depend upon degree of burden. *Gillespie* v. *Oklahoma,* 257 U. S. 501, 505; *Metcalf & Eddy* v. *Mitchell, supra,* p. 522. In this class fall municipal securities. *Weston* v. *Charleston,* 2 Pet. 449, 468; *Pollock* v. *Farmers Loan & Trust Co.,* 157 U. S. 429, s. c., 158 U. S. 601.

This Court has not made close distinctions between income generally and the special form of income strictly known as interest. In several cases where the income was held to be exempt it was not interest at all. *Gillespie* v. *Oklahoma, supra; Choctaw & Gulf R. Co.* v. *Harrison,* 235 U. S. 292. And in other cases where the income was strict interest the Court has generally rested the exemption on the broader ground, that it was income. *Pollock* v. *Farmers Loan & Trust Co.,* 157 U. S. 583–586, 601–604 652, 653, s. c., 158 U. S. 618, 666, 680, 693.

Nor has this Court made close distinctions as to the manner in which income from exempt instrumentalities is made. The principle is not that payments made by the municipality are free from tax because so paid, but that " the right to tax the contract, to any extent, when made must operate upon the power to borrow before it is exercised, and have a sensible influence upon the contract. The extent of this influence depends upon the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of the government." *Weston* v. *Charleston,* 2 Pet. 449, 468.

It is therefore clearly settled that any direct tax by either Government on income from the public securities of the other is prohibited. The remaining question is whether the income in this case was in fact derived from the municipal securities in question or whether it was, as claimed by the petitioner, " derived from a combination of capital, industry and skill."

Respondent is not a dealer in securities. He bought these bonds for cash, and as investments. He held them for five years. It is very difficult in fact to assign the profit which he realized upon the sale to anything except the securities themselves. It was simply a portion of the income which he made by the investment of his capital. In *Eisner* v. *Macomber,* 252 U. S. 189, at p. 207, this Court defined " gain derived from capital." Within that defini-

tion, this income was derived from the capital invested in these securities, and not from industry or labor.

The contention that a direct tax on the income from municipal securities is void is not weakened by a demonstration that Federal Estate Tax may be imposed on the transfer of state bonds (*Greiner* v. *Lewellyn,* 258 U. S. 384), or *vice versa* (*Plummer* v. *Coler,* 178 U. S. 115), or that a State may tax bank shares at a value based in part on the bank's holding of federal securities (*Van Allen* v. *Assessors,* 3 Wall. 573), or that Congress may tax banks although part of their deposits are state funds (*Manhattan Co.* v. *Blake,* 148 U. S. 412), or that a corporation excise tax may be measured by net income which includes interest from tax exempt securities (*Flint* v. *Stone Tracy Co.,* 220 U. S. 107). In all these cases the tax is on a legitimate and separate subject of taxation, and is not held improper (subject to the limitation enforced in *Macallen Co.* v. *Massachusetts,* 279 U. S. 620) because part of the measure of the tax results from property which would be exempt if taxed directly. So no doubt it would be proper to impose an excise tax on the business of dealing in securities, measured by the profits of the business, although some of the securities dealt in were municipals. But that is not this case.

The tax is illegal because it is in fact an appreciable burden upon the borrowing power of the States. It cannot be disputed that the usual inducements to an investment purchase of securities are two: the direct return in dividends or interest expected, and the hope of profit by increased value of the security itself. The second inducement is no doubt most present in the case of common stocks, but that it is absent in the case of fixed income securities is not a safe assumption. The State, like other solvent borrowers, may sell securities either at high coupon rates at par or at a premium, or at low coupon rates at a discount below par. Most private borrowers

find it good business to adopt the latter plan. The reason obviously is that the certain increment of value as bonds approach maturity induces lenders to accept a lower direct interest return. Also, in a time of generally high interest rates, fixed interest securities are favored by competent investors because they know that, as the going rates of interest decline, the value of the security itself is certain to increase. That increment in many cases can only be realized by sale. A tax upon it is a tax on a gain that the investor hopes to make by his investment. Necessarily it tends to compel a higher coupon rate upon state bonds than would otherwise be needed. It is a burden on the State, only one step less direct than a tax on the interest itself.

This was the view of both the courts below, and was quite recently the view of the Treasury Department as to federal securities, as evidenced by bills prepared by the Department and recommended by the Secretary to the Congress, to authorize the sale of Treasury bills, non-interest bearing, upon a discount basis. See United States Daily, Apr. 23, 1929, pp. 429, 435, Apr. 25, 1929, p. 457. The bills were passed in an amended form. Act of June 17, 1929, c. 26, 46 Stat. 19. But the form in which they were prepared by the Department demonstrates its expert view that taxation by the States on the profits made by sale of federal securities would affect adversely the excellent market which such securities command. The burden works both ways, and, if this conclusion of the Treasury was right, it follows that federal taxation of gains made on sale of municipal securities is a burden on the States. As such, it is invalid.

Messrs. Joseph E. Warner, Attorney General of Massachusetts, *R. Ammi Cutter,* Assistant Attorney General, and *Henry F. Long,* Commissioner of Corporations and

Taxation, by special leave of Court, filed a brief on behalf of the Commonwealth of Massachusetts as *amicus curiae.*

Messrs. Hamilton Ward, Attorney General of New York, and *Henry S. Manley,* Assistant Attorney General, by special leave of Court, filed a brief on behalf of the State of New York as *amicus curiae.*

MR. CHIEF JUSTICE HUGHES delivered the opinion of the Court.

The respondent, Charles W. Bunn, in the years 1919 and 1920, purchased for cash, as investments, bonds issued by various counties and cities in the State of Minnesota. In January, 1924, he sold these bonds, realizing a net profit of $736.26. Upon this net profit, less a net loss of $41.20 suffered by him on similar bonds held less than two years, the Commissioner of Internal Revenue determined an additional income tax in the amount of $85.44. The plaintiff paid this amount to the Collector, under protest, and claimed a refund upon the ground that the tax was illegal because assessed upon income from municipal bonds. The claim was rejected and this suit was brought against the Collector to recover the money paid.

The complaint, alleging these facts, charged that the Revenue Act of 1924, if thus applied, was unconstitutional and void in that the tax was laid upon the instrumentalities of States. Demurrer to the complaint was overruled by the District Court, and, the defendant having declined to plead further, judgment was entered for the plaintiff. The judgment was affirmed by the Circuit Court of Appeals, and this Court granted a writ of certiorari.

The Revenue Act of 1924 (c. 234, sec. 213, 43 Stat. 253, 267, 268, U. S. C. Tit. 26, sec. 954) clearly authorized the

tax. The Act included in the term "gross income" the gains and profits derived from "sales, or dealings in property, whether real or personal." See *Irwin* v. *Gavit,* 268 U. S. 161, 166. The Act gave an express exemption to "interest upon the obligations of a State, Territory or any political subdivision thereof," but this exemption was not extended to profits realized on the sale of such obligations, and the statement of the Government is not challenged that it has been the uniform practice of the Treasury Department in administering the federal income tax acts to include in taxable income the gain derived from the sale of state and municipal bonds.

The authority of the Congress to lay a tax on the profit realized by an investor from the sale or conversion of capital assets in general is not open to dispute and is not disputed. That is a matter of governmental policy and not of constitutional power.[1] The question raised here is not because the securities sold were capital assets but because they were governmental in character.

The question is further limited by the fact that it does not appear that the securities were issued at a discount, so that the gain derived could be considered to be in lieu of interest. Whatever questions might arise in cases of that sort are not now before the court.[2] The present case is simply one of profit obtained from purchase and sale, without qualification by any special circumstances.

The well-established principle is invoked that a tax upon the instrumentalities of the States is forbidden by

[1] *Merchants' Loan and Trust Co.* v. *Smietanka,* 255 U. S. 509, 519, 520; *Goodrich* v. *Edwards,* 255 U. S. 527; *Walsh* v. *Brewster,* 255 U. S. 536.

[2] It appears that the Treasury Department has ruled that where a municipality originally issues a bond at a discount and redeems it at par, the return represented by the discount is interest in another form and is not taxable. See O. D. 647, Cumulative Bulletin No. 3, July–December, 1920, p. 123; O. D. 737, *id.* p. 49; O. D. 762, Cumulative Bulletin No. 4, January–June, 1921, p. 31.

the Federal Constitution, the exemption resting upon necessary implication in order effectively to maintain our dual system of government.[3] The familiar aphorism is " that as the means and instrumentalities employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government." *Ambrosini* v. *United States,* 187 U. S. 1, 7. And a tax upon the obligations of a State or of its political subdivisions falls within the constitutional prohibition as a tax upon the exercise of the borrowing power of the State. *Pollock* v. *Farmers' Loan & Trust Company,* 157 U. S. 429, 584–586; *id.,* 158 U. S. 601, 618; *National Life Insurance Company* v. *United States,* 277 U. S. 508, 521.

The limitation of this principle to its appropriate applications is also important to the successful working of our governmental system. The power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of non-discriminatory laws, and where no direct burden is laid upon the governmental instrumentality, and there is only a remote, if any, influence upon the exercise of the functions of government. This distinction has had abundant illustration. Thus, while the salary of an officer of the State cannot be taxed by the Federal Government, the compensation paid by a State or a municipality to a

[3] *Collector* v. *Day,* 11 Wall. 113, 127; *United States* v. *Railroad Company,* 17 Wall. 322, 327; *Mercantile Bank* v. *New York,* 121 U. S. 138, 162; *Pollock* v. *Farmers' Loan & Trust Company,* 157 U. S. 429, 584–586; *id.,* 158 U. S. 601, 618; *Ambrosini* v. *United States,* 187 U. S. 1, 17; *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 523; *National Life Insurance Company* v. *United States,* 277 U. S. 508, 521.

consulting engineer, who is neither an officer nor an employee of government, for work on public projects, may be subjected to a federal income tax. *Metcalf & Eddy* v. *Mitchell,* 269 U. S. 514, 524. No constitutional implications prohibit a non-discriminatory tax upon the property of an agent of government merely because it is the property of such an agent and used in the conduct of the agent's operations and necessary for the agency. *McCulloch* v. *Maryland,* 4 Wheat. 316, 436; *Railroad Company* v. *Peniston,* 18 Wall. 5, 33; *Central Pacific Railroad Company* v. *California,* 162 U. S. 91, 126; *Baltimore Shipbuilding Company* v. *Baltimore,* 195 U. S. 375, 382; *Choctaw, Oklahoma & Gulf Railroad Company* v. *Mackey,* 256 U. S. 531, 537. The Congress may tax state banks upon the average amount of their deposits, although deposits of state funds by state officers are included. *Manhattan Company* v. *Blake,* 148 U. S. 412. Both the Congress and the States have the power to tax transfers or successions in case of death, and this power extends to the taxation by a State of bequests to the United States, and to the taxation by the Congress of bequests to States or their municipalities. *United States* v. *Perkins,* 163 U. S. 625; *Snyder* v. *Bettman,* 190 U. S. 249, 253, 254.

In the case of the obligations of a State or of its political subdivisions, the subject held to be exempt from federal taxation is the principal and interest of the obligations. *Pollock* v. *Farmers' Loan & Trust Company, supra.* These obligations constitute the contract made by the State, or by its political agency pursuant to its authority, and a tax upon the amounts payable by the terms of the contract has therefore been regarded as bearing directly upon the exercise of the borrowing power of the government. In *Weston* v. *Charleston,* 2 Pet. 449, 468, 469, where the tax, laid under an ordinance of the city council upon United States stock which had been issued for loans made to the United States, was held invalid, the principle was

thus stated by Chief Justice Marshall: "The right to tax the contract to any extent, when made, must operate upon the power to borrow, before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government. . . . The tax on government stock is thought by this Court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States, and consequently, to be repugnant to the constitution." This language was applied by the Court in *Pollock* v. *Farmers' Loan & Trust Company, supra*, (157 U. S. at p. 586) in holding invalid federal taxation "on the interest" from municipal securities.

But it does not follow, because a tax on the interest payable on state and municipal bonds is a tax on the bonds and therefore forbidden, that the Congress cannot impose a non-discriminatory excise tax upon the profits derived from the sale of such bonds. The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds. Because the tax in question is described as an "income tax" and the profits on sales are included in "income," the distinction is not lost between the nature of a tax applied to interest and that of a tax applied to gains from sales. The federal income tax acts cover taxes of different sorts. *Brushaber* v. *Union Pacific Railroad Company*, 240 U. S. 1, 17; *Stanton* v. *Baltic Mining Company*, 240 U. S. 103, 114. The tax upon interest is levied upon the return which comes to the owner of the security according to the provisions of the obligation and without any further transaction on his part. The tax falls upon the owner by virtue of the mere fact of ownership, regard-

less of use or disposition of the security. The tax upon profits made upon purchases and sales is an excise upon the result of the combination of several factors, including capital investment and, quite generally, some measure of sagacity; the gain may be regarded as "the creation of capital, industry and skill." *Tax Commissioner* v. *Putnam,* 227 Mass. 522, 531.

The tax not being on the obligations of the State or municipality, or on the investment therein, as such, the question is whether the tax must nevertheless be held to be invalid because sales by investors are to be deemed inseparably connected with the exercise of the borrowing power of the State. When the Constitution prohibits States from laying duties on imports, the prohibition not only extends to a tax upon the act of importing, but also to one upon the occupation of the importer or upon the articles imported. A tax on the sale of an article, imported only for sale, is a tax on the article itself. *Brown* v. *Maryland,* 12 Wheat. 419, 444. Similarly, with respect to federal taxation of articles exported from any State, the constitutional inhibition gives immunity to the process of exportation and to the transactions and documents embraced in that process. *Fairbank* v. *United States,* 181 U. S. 283; *United States* v. *Hvoslef,* 237 U. S. 1; *Thames & Mersey Marine Insurance Company* v. *United States,* 237 U. S. 19. Only on that construction can the constitutional safeguard be maintained. Again, when the United States has assumed duties with respect to Indian lands, a State cannot impose an occupation or privilege tax on operations conducted in or upon such lands by lessees who have been constituted federal instrumentalities for the purpose of discharging the Government's obligation, *Choctaw, Oklahoma & Gulf Railroad Company* v. *Harrison,* 235 U. S. 292, 298, or upon the leases themselves or capital stock representing them, *Indian Territory Illumi-*

nating Oil Company v. *Oklahoma*, 240 U. S. 522, 530, or upon the net income of such a lessee, *Gillespie* v. *Oklahoma*, 257 U. S. 501, 504. See, also, *Jaybird Mining Company* v. *Weir*, 271 U. S. 609, 612.[4] These cases are not analogous to the one under consideration. If the tax now in question is to be condemned, it must be because of practical consequences and not because purchases and sales by private owners of state and municipal bonds are a part of the State's action in borrowing money. It would be far-fetched to say that such purchases and sales are instrumentalities of the State. They are not transactions made directly or indirectly in behalf of the State or in the course of the performance of any duty of the State. Sales are merely methods of transferring title to the obligation, that is, the right to receive performance of the promise of the State or municipality.

That a transfer of government bonds is not inseparably connected with the exercise of the Government's borrowing power so as to make the transfer *per se* immune from taxation is clearly demonstrated by the decisions upholding non-discriminatory taxation laid upon the transmission of such securities upon the death of the owner. This Court has decided that a State may lay a transfer tax upon a legacy although it consists entirely of bonds of the United States, *Plummer* v. *Coler*, 178 U. S. 115, and that the Congress may tax the transfer of the net assets of a decedent's estate although municipal bonds are included in determining the net value, *Greiner* v. *Lewellyn*, 258 U. S. 384. In *Plummer* v. *Coler*, *supra* (p. 125), the tax of the State was sustained, despite the provision of the Act of Congress under which the bonds were issued that they should be exempt "from taxation in any form by or under State, municipal, or local authority." *Id.*, pp. 134,

[4] Compare *McCurdy* v. *United States*, 246 U. S. 263; *Shaw* v. *Gibson-Zahniser Oil Corporation*, 276 U. S. 575, 578, 579.

135; Act of July 14, 1870, c. 256, sec. 1, 16 Stat. 272; Rev. Stat., sec. 3701; U. S. C., Tit. 31, sec. 742. See, also *Orr* v. *Gilman*, 183 U. S. 278, 289; *Blodgett* v. *Silberman*, 277 U. S. 1, 12, 13. And in *Greiner* v. *Lewellyn*, *supra* (p. 387), the Court said that "the estate tax . . . like the earlier legacy or succession tax, is a duty or excise, and not a direct tax like that on income from municipal bonds. *Pollock* v. *Farmers' Loan & Trust Company*, *supra*. . . . Municipal bonds of a State stand in this respect in no different position from money payable to it. The transfer upon death is taxable, whatsoever the character of the property transferred and to whomsoever the transfer is made. It follows that in determining the amount of decedent's net estate municipal bonds were properly included." On similar grounds, as the Federal Government has power to tax transfers of property by gift *inter vivos*, *Bromley* v. *McCaughn*, 280 U. S. 124, there would seem to be no question of its constitutional authority to include in such taxation gifts of state or municipal securities.

It is urged, however, that a federal tax on the profits of sales of such securities should be deemed, as a practical matter, to lay such a burden on the exercise of the State's borrowing power as to make it necessary to deny to the Federal Government the constitutional authority to impose the tax. No facts as to actual consequences are brought to our attention, either by the record or by argument, showing that the inclusion in the federal tax of profits on sales of state and municipal bonds casts any appreciable burden on the States' borrowing power. We are left to the inadequate guidance of judicial notice. It may be considered to be a matter of common knowledge that the bonds of States and their municipalities are for the most part purchased for investment. But while, in the language of the tax act regarding deductions for losses, the purchase of municipal bonds for investment, as in the

case of other investments, may be regarded as "entered into for profit" as distinguished from mere personal use, it may be doubted whether the prospect on the part of the ordinary investor of obtaining profit on the resale of such obligations is so important an element in inducing their acquisition that a federal tax laid on such profits, in common with profits derived from the sales of other property, constitutes any substantial interference with the functions of state governments. While the tax is laid on gains, there is also a deduction for losses on sales, and whether investors in such securities would consider it an advantage if both provisions were eliminated is a matter of mere speculation. It must be remembered that we are dealing, not with any express constitutional restriction, but only with an asserted implication. The constitutional provisions authorizing the Congress to lay taxes (Article I, Section 8; Sixteenth Amendment), are certainly broad enough to cover the tax in question, and before we can restrict their application upon the ground of a burden cast upon the State's borrowing power, where the tax is not laid upon the contracts made by the State in the exercise of that power, or upon the amounts payable thereunder, but is laid upon the result of distinct transactions by private owners, it must clearly appear that a substantial burden upon the borrowing power of the State would actually be imposed. But we have nothing but assertion and conjecture. The assertion might as easily be made as to the necessity of the complete immunity of such securities from federal taxation in the case of estate taxes, and, if mere conjecture were sufficient as to the possibility of a burden being cast by the tax on the essential authority of the State, it could be as readily entertained in the one case as in the other. Indeed, the existence of the illegal burden might be more easily assumed in the case of the estate tax, where the entire value of the securities, and not merely gains on sales, are taken into the reckoning in determining the amount of the tax.

There is, however, an outstanding fact, more important than any possible conjecture. That fact is found in uniform and long-established practice. This practice clearly indicates that neither the Federal Government nor the States have found a tax on the profits of the sales of their securities to be a burden on their power to borrow money. So far as we are advised, the Federal Government has not at any time deemed it to be necessary to exempt from taxation the profits realized by owners on the sale of its obligations, with the exception, recently made, of short-term Treasury bills issued on a discount basis and payable without interest.[5] Such profits are included in the general

[5] In *Gray* v. *Darlington*, 15 Wall. 63, where the question related to the federal tax under the Act of March 2, 1867, 14 Stat. 477, 478, upon the profits on the sale of bonds of the United States, the point of the decision was that the statute applied only to *annual* "gains, profits and income" and did not extend to the increase in value of the bonds which had taken place in several prior years and was realized in the preceding year. But it was not questioned that annual gains or profits on the sale of government bonds were taxed by the Act. See *Hays* v. *Gauley Mountain Coal Co.*, 247 U. S. 189, 191.

In O. D. 729, Cumulative Bulletin No. 3, July–December, 1920, pp. 123, 124, the Treasury Department ruled: "In the case of Treasury certificates of indebtedness which are offered by the Government at par and accrued interest and not at a discount, only the coupon interest can be considered exempt from normal tax, and from surtax to the extent provided by the act approved September 24, 1917. Where such certificates are subsequently purchased at a discount, the difference between the purchase price and the par value of the certificates received at maturity is profit subject to both normal tax and surtax. The subscriber for Treasury certificates who sells them at a discount sustains a deductible loss, which is the difference between the par value of the certificates and the selling price. Any gain or loss on the sale of Treasury certificates of indebtedness prior to maturity should be determined in accordance with section 202 of the Revenue Act of 1918."

In the 71st Congress, 1st session, an amendment was proposed to section 5 of the Second Liberty Bond Act as amended (40 Stat. 290,

phrase "gains, profits and income" from "sales, or dealings in property," in the Act under consideration. And we understand that under all federal income tax acts, these or similar words have been construed invariably by the administrative authorities as including profits derived from the sale of state and municipal bonds. The present case appears to be the first in which the tax in this respect has been assailed. No State has ever appeared at the Bar of this Court to complain of this federal tax, and it is not without significance that in the present instance the

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U. S. C., Tit. 31, § 754), providing for the issue of Treasury bills "on a discount basis and payable at maturity without interest" and that [subdivision (b)] all certificates of indebtedness and treasury bills issued thereunder "both as to principal and interest, *and any gain from the sale or other disposition thereof shall be exempt* from all taxation (except estate or inheritance taxes) now or hereafter imposed by the United States, or by any local taxing authority; *and no loss from the sale or other disposition thereof shall be allowed as a deduction, or otherwise recognized, for the purposes of any tax now or hereafter imposed by the United States or any of its possessions.*" H. R. 1648, 71st Cong., 1st sess. The committee reports in the Senate and House of Representatives state that the amendment, in relation to both certificates of indebtedness and the new Treasury bills, "provides that gain from the sale of either shall be tax exempt, with the necessary supplementary provision that any loss shall not be recognized. Inasmuch as these are short-term obligations, any advance in price will as a practical matter represent nothing more than interest." 71st Cong., 1st sess., H. R. Rep. No. 13, Sen. Rep. No. 9. The words above italicized were, however, omitted in the act as passed. Act of June 17, 1929, c. 26, 46 Stat. 19, 20. By Act of June 7, 1930 (c. 512, 46 Stat. 775), a similar provision as to tax on profits on sales, but limited to the short-term Treasury bills issued at a discount, was enacted. The committee report in the House of Representatives stated that the reason for this enactment was found in the special nature of such Treasury bills. 71st Cong., 2d sess., H. R. Rep. Nos. 1609 and 1759. Aside from these Treasury bills, the federal tax on profits on sales of federal securities has not been changed.

States of New York and Massachusetts do appear here as *amici curiae* in defense of the tax.[6]

The history of income tax legislation is persuasive, if not controlling, upon the question of practical effect. *Plummer* v. *Coler, supra,* (pp. 137, 138). Before the power of the Congress to lay the excise tax in question can be denied in the view that it imposes a burden upon the States' borrowing power, it must appear that the burden is real, not imaginary; substantial, not negligible. We find no basis for that conclusion, nor any warrant for implying a constitutional restriction to defeat the tax.

Judgment reversed.

URAVIC, ADMINISTRATRIX, *v.* F. JARKA COMPANY, INCORPORATED, ET AL.

CERTIORARI TO THE SUPREME COURT OF NEW YORK.

No. 32. Argued December 8, 1930.—Decided January 5, 1931.

Section 33 of the Merchant Marine Act, which, in connection with the Employers' Liability Act, gives an action at common law to

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[6] Undoubtedly each of these States has in view the circumstance that it subjects to its own income taxation the gains derived from the sale of federal securities, and it does not desire, in the absence of an applicable legislative restriction, to be deprived of that source of revenue as a corollary of a decision against the power of the Federal Government to tax the gains derived from the sale of state securities. The State of New York disavows any claim that "the tax in question has any appreciable tendency to burden its fiscal operations" or those of its municipalities. The State of Massachusetts contends that: "1. The non-discriminatory taxation of all gains derived from the use of business knowledge and of human ingenuity in dealings in intangible property can have no material effect to impair the ability of a government to issue its bonds and obligations, even if gains from the sale of such bonds are subjected to the tax. 2. The history of the exemption of state instrumentalities from Federal taxation and of the exemption of Federal instrumentalities from state taxation reveals that the doctrine of exemption has protected governmental obligations only from taxation of the principal amount of such obligations and of the stated interest upon such obligations."